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TREASURY DEPARTMENT  
UNITED STATES INTERNAL REVENUE

# INCOME TAX PRIMER

FOR

## FARMERS

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PREPARED BY THE BUREAU OF INTERNAL REVENUE  
FOR THE INFORMATION AND ASSISTANCE  
OF TAXPAYERS

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(PRELIMINARY EDITION)



WASHINGTON  
GOVERNMENT PRINTING OFFICE  
1919

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# INCOME TAX PRIMER FOR FARMERS.

## RETURNS.

### 1. Who is a farmer?

The term "farmer" as used in this primer embraces persons operating stock, dairy, poultry, fruit, or truck farms, plantations, ranches, or any land used for fruit raising or agricultural purposes.

### 2. I am a farmer. Am I required to make a personal income tax return for 1918?

Yes; if your net income equals or exceeds the personal exemption to which you are entitled, or in any event if your net income equals or exceeds \$2,000.

### 3. To what personal exemptions am I entitled?

If you are a single person you are entitled to an exemption of \$1,000; if you are married and have been living with your wife or husband during the entire year or have been the head of a family during the entire year you are entitled to an additional exemption of \$1,000. You are also entitled to a further exemption, whether single or married or the head of a family, of \$200 for each person (other than husband or wife) dependent upon and receiving his chief support during the year from you, if such dependent person is under 18 years of age, or, regardless of age, is incapable of self-support because mentally or physically defective. If you are entitled to any of the foregoing exemptions during a part of the year only, you are entitled to as many twelfths of the exemptions stated as there were months in such part of the year to which you were entitled to the exemption. Any part of a month may be counted as a full month.

### 4. On June 15 my wife died, since which time I have been boarding. To what exemption am I entitled?

To an exemption of \$1,000, plus \$500, since you were married for one-half of the year.

### 5. On March 31, 1918, my wife died, since which time I have kept my home with my three small children. To what exemption am I entitled?

To an exemption of \$2,000 as head of a family, plus \$600 for the children. If you had not had any children dependent upon you and had not kept your home you would have been entitled to an exemption of \$1,000 plus \$250 for the time your wife lived with you, or a total of \$1,250.

### 6. On October 10, 1918, I married a widow with one dependent child 3 years old, both of whom I have supported since marriage. To what exemption am I entitled?

To an exemption of \$1,000 for yourself, an additional amount of \$250 for your wife, and \$50 for the child; total, \$1,300.

7. Who is entitled to be considered the "head of a family"?

A person who is the chief support of one or more persons living in his own household, who are closely related to him (or her) by blood, marriage, or adoption.

8. What is meant by the taxable year 1918?

The calendar year 1918 or any fiscal year ending during the calendar year 1918.

9. What does the term fiscal year mean?

An accounting period of 12 months ending on the last day of any month other than December.

10. Upon what period of time shall my 1918 income-tax return be based?

Upon the calendar year 1918.

11. I have been computing my net income upon a calendar-year basis as required of individuals by the income-tax laws in force prior to the revenue act of 1918. May I change the basis of computing my net income to that of a fiscal year?

Yes. If you have actually been keeping your books on the basis of an accounting period of 12 months ending on the last day of any month in the year 1918 other than December, you may make a return for such accounting period. The return should be made in the same way as a return for the calendar year 1918, and should include your entire income for the accounting period of 12 months for which the return is made. An adjustment will be made for the income which was also included in the return for the calendar year 1917. If you have not been keeping your books on the basis of an accounting period ending in a month other than December, you must make your return for the calendar year 1918. The revenue act of 1918 and the regulations provide a method for making a change in future years, but no change can be made with respect to the return for the year 1918.

12. My principal crop is tobacco. I keep books of account which accurately show my true gains and profits, take annual inventories and close my books on March 31. My tax return for 1917 covered the calendar year 1917. Upon what period shall I make a return for 1918?

Since your normal accounting period is the fiscal year ending March 31, you should make a return showing your true net income from April 1, 1917, to March 31, 1918. An adjustment will be made for the income which was also included in the return for the calendar year 1917. This will serve to establish your fiscal year as ending on March 31. This return should be filed with the collector on or before March 15, 1919. Section 227 (a) of the revenue act of 1918 requires that returns made on the basis of a fiscal year shall be filed "on or before the 15th day of the third month following the close of the fiscal year." Therefore, on or before June 15, 1919, you should file a return of net income covering your fiscal year ending March 31, 1919.

13. Where should my personal return for the year 1918 be filed?

Section 227 (b) of the revenue act of 1918 provides that your return shall be filed with the collector of internal revenue

for the district in which you have your legal residence or principal place of business. If your legal residence is located in one collection district and your principal place of business in another, it is optional with which collector your return shall be filed; but for administrative reasons the Commissioner of Internal Revenue desires that it be filed with the collector of the district in which your legal residence is located.

14. When may my 1918 return be filed with a collector of internal revenue?

On any day after December 31, 1918, but not later than March 15, 1919.

15. Will failure to file my return within the time prescribed by law render me liable to any penalty?

He would become liable, under the provisions of section 253 of the revenue act of 1918, to a fine of not to exceed \$10,000, or to one year's imprisonment or both, in the discretion of the court, and to the costs of prosecution, and if he made an understatement of the tax which was false with intent to evade the tax, to a penalty of 50 per cent of the amount of the deficiency. If he willfully made a return which was false or fraudulent in other respects he would, under section 3176 of the Revised Statutes, be liable to an additional penalty of 50 per cent of the amount of the entire tax.

16. May an extension of time beyond March 15, 1919, be obtained for the filing of my 1918 return?

Yes. If, on account of illness or absence from home, you are unable to file your return within the time prescribed by law, you may obtain an extension of 30 days if a request therefor is made to the collector of your district within the period covered by the extension asked for. In this request you must state the reason why the return can not be filed within the time prescribed by law.

17. Would a personal return made by an agent, for and in my behalf, be accepted?

If, by reason of illness, absence, or nonresidence a taxpayer is unable personally to make his return he may appoint an agent to act for him and the return executed by the agent will be accepted if he makes affidavit that he has sufficient knowledge to make a complete and accurate return for his principal. Such agent assumes responsibility for making the return properly, and the penalties provided for a delinquent, erroneous, false, or fraudulent return are applicable to him.

18. May a husband and wife living together make separate returns?

Yes. They should in every case make separate returns where the wife has a separate income and the aggregate net income of both husband and wife is \$5,000 or over. Where the combined net income in excess of credits (see question 101) is in excess of \$4,000 separate returns must be made in order that there shall not be an overassessment of tax. Husband and wife living together are entitled to a personal exemption of not to exceed \$2,000 against their aggregate net income. If separate returns are made the personal exemption of \$2,000 may be taken by either or divided between them.

19. If a husband and wife make a joint return showing net income in excess of \$5,000 is the surtax upon that return based upon the aggregate amount of net income shown?

If a statement is attached to the return showing the amount of the wife's net income included in the return the surtax will be assessed only against the separate income of each in excess of \$5,000. But, as indicated in the answer to question 18, separate returns should be made where the net income of both husband and wife is in excess of \$5,000.

20. Where can I get a blank form upon which to make my return?

From the collector of internal revenue for your district. The collector will endeavor to have such forms sent to you, but failure to receive one will not excuse you from making a return. If you do not receive one, it is your duty to request the collector to furnish you with a blank form.

#### RATE OF TAX.

21. What personal income taxes are imposed upon income received during the calendar year 1918?

The normal income tax on the income of every individual citizen or resident of the United States is at the rate of 6 per cent upon the first \$4,000 of the net income in excess of credits allowed (see question 101) and 12 per cent upon the excess over that amount. A person receiving a net income in excess of \$5,000 is liable to a surtax of 1 per cent upon income from \$5,000 to \$6,000; 2 per cent upon income from \$6,000 to \$8,000; 3 per cent upon income from \$8,000 to \$10,000, etc. Assuming that a man's net income for 1918 was \$9,000 and that he was entitled to \$2,800 credits, his tax would be computed as follows:

#### NORMAL TAX.

Income from \$2,800 to \$6,800, at 6 per cent-----	\$240
Income from \$6,800 to \$9,000, at 12 per cent-----	264

#### SURTAX.

Income from \$5,000 to \$6,000, at 1 per cent-----	10
Income from \$6,000 to \$8,000, at 2 per cent-----	40
Income from \$8,000 to \$9,000, at 3 per cent-----	30
Total tax -----	584

#### NET INCOME.

22. What is meant by the term "net income"?

Net income means your total gross income, not including income exempt from the tax by law, less the general deductions allowed by law.

#### EXEMPT INCOME.

23. What income of an individual is exempt from income tax?

(a) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;



(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(c) The value of the property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

(d) Interest upon (1) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (2) securities issued under the provisions of the Federal farm loan act of July 17, 1916; or (3) the obligations of the United States or its possessions, except as follows: In the case of obligations of the United States issued after September 1, 1917, the interest shall be exempt only if and to the extent provided in the respective acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer;

(e) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(f) So much of the amount received during the present war by a person in the military or naval forces of the United States as salary or compensation in any form from the United States for active services in such forces, as does not exceed \$3,500.

24. Am I required to make any return of income wholly exempt from income tax?

The law requires that every person owning any of the obligations, securities, or bonds enumerated in clauses (1), (2), and (3) of paragraph (d) above shall submit a statement showing the number and amount of such obligations, securities, and bonds owned by him and the income received therefrom. There is a place on the return form for showing such information.

25. To what extent is interest received upon Liberty bonds exempt from income tax?

(a) All interest received upon Liberty bonds is exempt from normal tax.

(b) In any event, interest upon the 3½ per cent Liberty bonds of the first series is exempt from both normal tax and surtax.

(c) In addition, a person is entitled to exemption from tax upon interest received on \$5,000 aggregate amount of bonds and war-savings certificates.

(d) If one originally subscribed for Liberty bonds of the fourth series, he is also entitled to an exemption from tax on interest received upon bonds of the previous issues, not to exceed one and one-half times the amount of the fourth Liberty loan bonds, originally subscribed for and still owned, not to exceed in the aggregate \$45,000.

(e) The interest received on not exceeding \$30,000 principal amount of Liberty bonds into which first Liberty bonds may have been converted in the exercise of any privilege arising as a consequence of the issue of the fourth Liberty bonds is exempt.

(f) The interest received on not exceeding \$30,000 principal amount of Liberty bonds of the fourth issue is exempt.

The interest upon Liberty bonds which is entirely exempt from income tax, as defined above, should not be included in the gross income of the return.

#### GROSS INCOME.

#### 26. What is meant by "gross income"?

Gross income includes *gains, profits, and income derived from every source whatever*, unless wholly exempt from income tax.

#### GROSS INCOME WHERE THE ONLY BOOKS OF ACCOUNT ARE THOSE OF RECEIPTS AND DISBURSEMENTS.

#### 27. The only books of account which I have ever kept are those of receipts and disbursements. How shall I compute my gross income?

You must include in gross income the proceeds of sales of all stock or other farm products. With respect to animals purchased and used solely as draft and work animals or only for breeding purposes, which may be sold, any advance above the cost reduced by depreciation sustained in the manner described in the answer to question 33, is to be included in gross income. There must also be included in the gross income gains, profits, and income from all other sources.

#### 28. What items of gross income derived from my business of farming are to be reported in my income-tax return?

All amounts received from the sale of crops, dairy products, eggs, live stock, whether raised on the farm or not, live-stock products, fruit, and all other farm products, and all amounts received for board of persons, board and pasturage of animals, labor of men and teams, hire or use of machinery, and all other earnings arising from farming operations must be reported under the head of "Income from business or profession" on the tax return.

#### 29. I raised a large crop of wheat in 1918, but did not sell it until after the close of the year. Should I include the proceeds from the sale of this wheat in my return for 1918?

No. All gains, profits, and income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold by the farmer, must be included in the return of income for the year in which the products were actually marketed and sold.

#### 30. In 1918, I sold wheat which was raised in 1915, 1916, and 1917. May I deduct the expense of producing this wheat in computing my profits, or must I include in gross income the total amount received for my wheat?

Where the cost of stock or farm products purchased in previous years for resale or the expense of producing stock or products on the farm has been claimed as a deduction or taken into consideration in ascertaining the farmer's liability to income tax for some year prior to 1918, the entire proceeds of the sale are to be returned as income for the year in which the sale was made, for the reason that the farmer having once received the benefit of the deduction is not again entitled to it. If, however, such cost or expense has not been claimed as a deduction or has not been taken into consideration in ascertaining the farmer's liability to income tax for a previous year the amount of such cost or expense may be deducted from the selling price of the stock or farm products and the difference only returned as gross income.

31. I rent a farm on shares. When is my share of the crops and stock to be taken into consideration in making up my return?

In the year in which they are sold or converted into the equivalent of cash.

32. How am I to determine the amount of gain or profit derived from sale of property which is returnable for income-tax purposes?

If you acquired the property sold prior to March 1, 1913, you should take its fair market price or value of that date, add thereto all amounts subsequently expended in making improvements, deduct therefrom depreciation sustained for years prior to 1918, and the difference between the result obtained and the selling price is the amount to be reported under gross income.

If you purchased the property on or after March 1, 1913, the difference between its cost plus all amounts subsequently expended for permanent improvements less depreciation sustained for years prior to 1918 and its selling price is to be returned.

If the property came to you on or after March 1, 1913, as an inheritance the difference between the appraisal value placed upon it at the date of the death of the testator plus all amounts subsequently expended for permanent improvements less depreciation as above indicated and its selling price is to be returned.

33. How is the value as of March 1, 1913, of property sold in 1918 to be determined?

No method of determining this value can be stated which will adequately meet all circumstances. What that value was is a question of fact to be established by any evidence which will reasonably or adequately make it appear.

34. I sold a farm in 1918 for \$12,000 which I purchased in 1910 for \$4,000. Its fair market price or value on March 1, 1913, was \$6,000. Subsequent to that date, I have spent \$2,000 for permanent improvements upon the place and have deducted \$1,000 for depreciation in my income-tax returns. How much of the \$12,000 received must I include in gross income?

\$5,000.

35. I sold some shares of bank stock in 1918 for \$5,000. This stock was purchased by me in 1914 for \$3,000. I have paid \$400

interest in past years upon indebtedness incurred in the purchase and carrying of the stock. How much of the \$5,000 received by me must I include in gross income?

The interest paid by you was a deductible expense from gross income in income-tax returns for the years in which paid. You are therefore required to include in gross income of 1918 the entire difference between the cost and the sale price, or \$2,000.

36. I sold cattle in 1918 which I raised on my farm. Must I return in gross income the full amount received for them?

Yes, if born since March 1, 1913. If born before that date, the value on that date may be deducted from the sale price in ascertaining the income.

37. I sold a pair of horses in 1918 for \$500 which I purchased in 1915 for \$300. Must I return in gross income the full amount of \$500 received?

No. The profit realized upon a sale, in this case \$200, must be included in income. The case would be different if the live stock had been raised on the farm. In such case there is no capital investment and the full amount received must be included in income.

38. I exchanged a farm in 1918, which cost me in 1910 \$3,000, for rented property in town. The farm was reasonably worth on March 1, 1913, the amount of \$5,000. The value of the property I received in exchange was \$10,000. Did I receive any taxable income from the transaction?

The taxing act provides that "when property is exchanged for other property the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any." Since the property received in exchange was worth \$10,000, your profit on the transaction was \$5,000 and that amount must be included in gross income.

39. If a farmer exchanges produce for merchandise, groceries, etc., is the value of such merchandise to be returned for tax purposes?

Yes; the price placed by the merchant upon the goods exchanged for farm produce is to be included as income in the farmer's return.

40. A tenant, under the terms of a lease, is required to pay a certain cash rental and in addition make certain improvements. Is the cost of these improvements held to be taxable income to the property owner?

Report cash rental for year in which received. The value of improvements made should be returned as income to the lessor for the year during which the lease terminates.

41. I have two children who live at home and are regularly employed. One is 17 years old; the other 21 years old. Am I required to include the amount of income which accrues to each during a calendar year in my own personal return?

As the first child has not reached its majority and is still legally under your control, the amount of its income is to be included in your personal return and is subject to tax in your

hands. The income of the child which has attained its majority is not to be included in your return and is only subject to tax in the hands of that child.

42. I purchased a 6 per cent \$100 coupon bond at its face value, plus \$1.50; that is, three months' accrued interest. Three months later I detached a coupon therefrom and collected \$3 interest. Must the entire amount of interest received be returned as income.

No. Report only so much interest as accrued after the date of your purchase. It is the seller's duty to report the balance.

43. Do the pensions and retired pay of ex-officers and men of the United States military and naval forces constitute items of taxable income?

Yes.

44. I own stock in a bank which, under a State law, is required to pay the taxes assessed against such stock. How is this matter to be handled for income-tax purposes?

The proportionate part of the entire amount of taxes so paid by the bank, which is properly chargeable against the number of shares held by you, should be reported, for additional tax purposes, in your personal return as a dividend, and then claimed as a deduction under the heading of "Taxes."

45. Are amounts placed to the credit of a shareholder in a building and loan association subject to income tax?

Any amount credited to a shareholder when the title to such credit passes to the latter at the time of the credit has a taxable status for the normal and additional income tax and should be included in the return rendered for the year during which the credit is made.

46. Where service is rendered for a stipulated price, wage, or salary, and paid with something other than money, shall consideration be given the transaction for income-tax purposes?

Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary, such price will be presumed to be the fair value of the compensation received.

47. In 1918 I received payment of a note and interest accrued for the preceding five years. The amount of the note was \$1,000 and the amount of the accrued interest \$300. The note was in payment of a tract of land I sold in 1913. Am I required to return the full amount received in my gross income?

No; but you are required to include the full amount of interest received.

48. During the year 1918 \$60 was placed to my credit by banks in which I had money deposited, which amount represented interest upon my deposits. Does this interest, which was not received by me in cash or withdrawn from the bank, constitute a part of my gross income for 1918?

Yes. Interest which is placed to one's credit and which may be received constitutes a part of the gross income.

49. I market my dairy products through a cooperative association and during the year 1918 I received \$300 in dividends from the association. Am I required to include these dividends in my gross income and are they exempt from normal tax the same as dividends received upon my shares of bank stock?

All dividends from cooperative associations must be included in gross income. They are not exempt from normal tax for the reason that the association itself is not taxed upon its earnings. The dividends simply represent additional amounts accruing to you upon sales through the association.

50. Are dividends from cooperative buying associations to be treated the same as dividends from cooperative selling associations?

Yes.

51. In rendering my 1915 return I claimed a deduction to cover a debt I then believed to be absolutely worthless. In 1918 the debtor has discharged part of his obligations. How should I treat this payment for income-tax purposes?

Consider it as an item of income and include this amount under "Gross income" in your 1918 return.

52. I had cattle, which I raised and which were worth \$500, killed by lightning. The cattle were insured and I received \$500 insurance money. Must this be included in income?

Yes. For income-tax purposes the receipt is the equivalent of a sale. It constitutes income to you.

53. Are there any items of income, other than those above suggested, which should be included in gross income?

Income from every source not wholly exempt from income tax (see answer to question 23) must be included. These include income from salaries and wages, rents, interest on notes, mortgages, etc.; also income from trustees and partnerships, royalties from mines, oil and gas wells, dividends on stocks, etc.

#### DEDUCTIONS FROM GROSS INCOME.

54. What deductions are allowed from gross income in arriving at net income?

The taxing act allows the following deductions from gross income in ascertaining net income:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

(2) All interest paid or accrued within the taxable year on indebtedness (except on indebtedness incurred or continued to purchase or carry obligations or securities, the interest upon which is wholly exempt from taxation as income to the taxpayer).

(3) Taxes paid or accrued within the taxable year except Federal income, war-profits, and excess-profits taxes, and except taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business.

(6) Losses sustained during the taxable year on property not connected with the trade or business, if arising from fires, storms, shipwrecks, or other casualty, or from theft, and if not compensated for by insurance or otherwise.

(7) Debts ascertained to be worthless and charged off within the taxable year.

(8) A reasonable allowance for the exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

(9) In the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion and for depreciation of improvements according to the peculiar conditions in each case, based upon costs, including cost of development not otherwise deducted.

(10) Contributions or gifts made within the taxable year, to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation, authorized by section 7 of the Vocational Rehabilitation act, to an amount not in excess of 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph.

55. What items are not deductible from gross income?

Section 215 of the act provides:

That in computing net income no deduction shall in any case be allowed in respect of—

(a) Personal, living, or family expense;

(b) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(c) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

(d) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

ORDINARY AND NECESSARY EXPENSES.

56. What are the principal ordinary and necessary expenses deductible?

All amounts actually paid for labor in preparing land for a crop, and the cultivation, harvesting, and marketing of the crop; the cost of the seed and fertilizer used; the amounts expended for labor used in caring for live stock and the cost of the feed; the amounts actually paid in making repairs to farm buildings, but not the dwelling house; repairs to fences, farm machinery, etc.; the cost of materials for immediate use, and farm tools which are used up in the course of a year or so,

such as pitchforks, spades, and similar tools, but not including farm implements, machinery, wagons, and other vehicles which are regarded as capital investments; and the amount of rent paid for a farm may also be claimed. The amounts paid as the purchase price for live stock, including draft and work animals, are held to represent capital investments and are not allowable as deductions. Amounts paid as the purchase price of an automobile even though used wholly or partly in the business are not deductible because such amounts represent capital investments. A reasonable allowance for depreciation may be claimed based upon a portion of the cost in the ratio that the use of the automobile for business purposes bears to its use for pleasure or for personal and family convenience.

57. Are any payments for permanent improvements to my farm deductible?

No. They are not expenses. They are investments of capital.

58. May I deduct from gross income the cost of dairy cattle which may be resold?

No. The cost of the cattle materially adds to the value of your possessions. If the cattle purchased are resold at a profit, you will be required to consider as profits only the difference between the cost and the selling price.

59. I purchased in 1918 a mowing machine and cultivator, at a cost of \$150, and small hand tools at a cost of \$50. Can these amounts be deducted from gross income?

The cost of the hand tools may be deducted as an ordinary expense. The purchase of the cultivator and mowing machine constitute improvements. They have an estimated life of more than one year, and payment for them should be considered capital expenditures. A reasonable amount of depreciation of the machines may be deducted from gross income.

60. Can payments of premiums on insurance policies for insurance against fire, hail, tornado, or windstorm be deducted?

The cost of insurance of crops and of farm buildings, other than the farm dwelling, is deductible.

61. Can the cost of gasoline, repairs, and upkeep of an automobile or other vehicle used partly for business purposes and partly for pleasure be deducted?

If the automobile is used one-half of the time or one-third of the time for business purposes, the same fractional part of the cost of repairs, etc., may be deducted as a necessary expense. No deduction may be made if the automobile is used solely for the pleasure or personal convenience of the taxpayer or his family.

62. Are the items of expense incurred and paid by me during the calendar year in connection with a farm which I lease to another on a cash or crop-share rental basis, such as repairs to fences, farm buildings, etc., allowable as deductions?

Yes.

63. A tenant, under the terms of a lease, is obliged to pay a certain cash rental and all taxes assessed against the property and keep it insured. May he claim as a business expense the



aggregate amount of rental, taxes, and insurance premiums paid?

Yes; if the property is used by the tenant for business or trade purposes and not as a home, the aggregate amount may be claimed as a deduction for the year during which actually paid.

64. I own stock in a corporation which, in 1918, assessed each of its stockholders \$50 on each share held. Can the amount paid by me be claimed as a deduction?

No. Assessments made by a corporation on its capital stock are regarded as further investments of capital and do not constitute an allowable deduction in the return of the individual.

65. Can the value of a crop paid to the landlord by the tenant be deducted as an expense by the tenant?

No. It is not a part of the expenses *paid* by him. He may deduct all amounts paid by him in raising the crop.

66. I employ a man to assist me in operating my farm and a woman to assist about the house. Is the compensation paid to each allowable as a deduction?

Unquestionably, as to the amount paid to the male employee, but a line must be drawn as to the amount paid to the female employee. If her time is employed entirely in taking care of milk and cream produced for sale, in the production of butter, cheese, etc., the care of milk cans and churns, or, if a separate table is maintained for laborers employed on the farm and her services are used entirely in the preparation and serving of the meals furnished the laborers and in caring for their rooms, the compensation paid her constitutes an allowable deduction. If, however, she is employed to assist in caring for the farmer's own household, no deduction can be claimed.

67. If I employ a minor son or daughter to assist me in my business or trade and I pay a salary or wage for such assistance, may I claim the amount as a deduction?

No. If, however, the son or daughter has attained his or her majority, the amount of compensation paid for his or her services may be so claimed.

68. In purchasing fertilizers I gave notes in payment which I had not paid at the close of the year. Should the cost of the fertilizers be deducted in the year in which I gave the notes or in the year in which I paid them?

Payment by a note is the equivalent of a payment in cash. Therefore, the cost of the fertilizers should be deducted from income in the year in which the notes were given.

69. I pay dues to a county social club. Are these payments deductible?

No; such dues are a personal expense rather than a business expense.

70. In California and other States fruit growers, ranchers, and farmers are shareholders in irrigation companies, which are mutual in character, and they are often assessed, in proportion to their holdings of stock, for sufficient amounts to make repairs to the irrigation system, cleaning out pipes, laterals,

etc. Can such assessments be claimed as deductions under the head of business expenses?

Yes. Where the purpose of the assessment is merely to raise funds to keep the irrigation system in usable condition and not to make extensions or betterments, the amount assessed against each shareholder may be so claimed.

71. While driving my automobile I collided with a vehicle and was compelled to pay \$100 in settlement. Is this payment deductible?

If you were riding for pleasure it is a personal expense and is not deductible. If the automobile was being used in connection with your business at the time it is deductible.

72. I purchased a threshing machine at an auction. Is the amount I paid a legal deduction?

No; it is an investment of capital.

73. Can the cost of digging irrigation ditches be deducted as an expense?

No; but the cost of repairing such ditches may be deducted.

#### INTEREST.

74. Can all interest paid on indebtedness be deducted?

Yes; except on indebtedness to purchase or carry securities (like municipal or county bonds) the income from which is wholly exempt from tax.

#### TAXES.

75. Can all taxes be deducted?

Yes; with the exception of United States income, and excess-profits taxes, inheritance or legacy taxes, and assessments against local benefits of a kind tending to increase the value of the property assessed.

76. Am I not entitled to deduct the income tax which I paid to the collector in 1918?

No.

#### LOSSES.

77. What losses can be deducted?

See the answer to question 54.

78. My wheat crop was ruined by hail. I had no insurance. May I deduct the value of the crop as a loss?

No. The value of the crop has never entered into gross income. The cost of raising the crop is deductible as a necessary expense.

79. How am I to determine what amount of loss, resulting from a sale of property, is allowable as a deduction?

The same method of computation should be followed as is outlined in the answer to the thirty-second question. If the result is a loss instead of a gain, that loss may be claimed as a deduction.

80. Suppose I buy a farm, which is much run down, with the intention of making it a profit-paying property—that is, I intend to operate it for profit and not for recreation or pleasure. To do this I am obliged to expend large amounts for labor in plowing and cultivating the land, for fertilizer, lime, etc., and for several years the expenses will greatly exceed the

gross receipts. Can the excess of expenses over receipts for each year be claimed as a loss?

It is held that all such necessary expenses as contemplated by the income-tax law of cultivating, operating, or managing a farm on a basis embodying the recognized principles of commercial farming, for the purpose of gain or profit and not for recreation or pleasure, may be claimed as deductions in returns of income, even though these expenses exceed the income from the farm and the result is a continued loss, provided the farm is continued to be operated on a strictly commercial basis.

81. I own a tract of timber which was partially destroyed by fire during 1917. Is this loss allowable as a deduction?

The actual amount of capital invested in standing timber, if acquired on or after March 1, 1913, and later destroyed by fire, may be claimed as a deduction if not reimbursed by insurance or otherwise. If the timber was acquired prior to March 1, 1913, its fair market price or value as of that date may be claimed. To illustrate the method to be employed in computing the amount of loss allowable as a deduction, the following is submitted: A tract of land was acquired prior to March 1, 1913, and the estimated amount of timber standing on that tract on that date was 1,000,000 feet, board measure, the fair market price or value per 1,000 feet established by the current prices prevailing in the locality of the tract in question as of March 1, 1913, being \$4. During the year 1917, 400,000 feet of this timber was destroyed by fire. In this case \$1,600 is the amount which may be claimed as a deduction.

82. If cattle or other live stock are produced on a farm which I own or operate, and are then lost through disease, may I claim their value at the time of death as an allowable deduction?

No. If the stock which died were purchased and the cost has not been claimed in a previous return as a deduction, that cost may be claimed as a deduction in your return rendered for the year during which the loss occurred.

83. My barn, which cost \$3,000 to build, was destroyed by lightning. I received \$2,000 insurance upon it. Am I entitled to deduct the full amount of the loss?

Your actual loss was \$1,000, and you are entitled to deduct this amount from gross income as a loss.

84. In 1918 I sold a pair of horses for \$400 for which I paid \$550 in 1915. Am I entitled to deduct the loss of \$150 sustained?

Yes, less any deduction heretofore claimed for depreciation.

85. I purchased \$5,000 Liberty bonds in May, 1918, paying \$5,000 for same. The market price of these bonds was only \$4,800 on December 31, 1918. Am I entitled to deduct a loss of \$200 on these securities?

No. The securities have not been sold and no loss has been sustained. No loss can be deducted until securities are disposed of and a loss actually is sustained.

#### DEBTS ASCERTAINED TO BE WORTHLESS.

86. What conditions are necessary in order that a debt may be claimed as a deduction?

It must be (a) a bona fide debt, (b) definitely ascertained to be worthless and uncollectible during the year for which the deduction is claimed, and (c) if books are kept it must be charged off within the year for which the deduction is claimed and no longer considered an asset or carried as such on the books.

87. In 1918 a corporation or a firm to which I had loaned money became bankrupt. Can this debt be considered absolutely worthless and claimed as a deduction for 1918?

Yes, if it is definitely known that nothing can be collected from the debtor itself or any person connected with it.

88. Is it absolutely necessary that the debtor corporation or firm mentioned in the eighty-seventh inquiry be declared a bankrupt and its receiver discharged before I can claim a deduction on account of the debt in question?

No. If the debtor corporation has no assets whatsoever available for application to the debt in question, and it is definitely known that nothing whatsoever can be collected from the debtor itself or any person connected with it, a creditor need not go to the expense of instituting bankruptcy proceedings in order to establish his right to claim the worthless debt as a deduction.

89. "A" indorses a note for "B." The latter has since departed for parts unknown and the note became due in 1918, and "A" was required to make good his indorsement. Can he now claim as a deduction the amount paid by him to the creditor?

Yes. If he has no knowledge of "B's" present whereabouts and has good reason to believe that he is possessed of no assets and that it is his intention never to make payment of it, the amount so paid by "A" may be considered a bad debt due him from "B."

#### DEPRECIATION.

90. What is depreciation?

Depreciation is a lessening in value of farm buildings, machinery, etc., employed in the business arising from wear, tear, or obsolescence.

91. At what rates may depreciation be claimed, and under what conditions?

The annual allowance for depreciation should be based upon the life of the property; that is, the cost of the property or the value of the same when acquired, if received by gift or bequest, or its fair market price or value as of March 1, 1913, if acquired prior thereto, should be ratably spread over its life. For instance, the rate of depreciation to be deducted on buildings used for business purposes, the probable life of which is 50 years, would be 2 per cent. The probable life means, of course, the number of years the property would be usable in business if ordinary repairs are made from the date of acquisition or in case of property acquired prior to March 1, 1913, the number of years the property would be usable from March 1, 1913. In the case of property acquired by gift or bequest, the "cost" of such property for depreciation purposes is the appraised value at the time the property was

acquired. If property in respect of which depreciation is claimed was acquired prior to March 1, 1913, the fair market value as of that date will be assumed to be, in the absence of proof to the contrary, the cost of the property, less depreciation up to that date.

In claiming depreciation the following fundamental principles must be taken into consideration:

(a) Only such depreciation as results from exhaustion, wear, and tear of property, arising out of its use or employment in business or trade, can be claimed. Depreciation in the value of a home or any article of property, such as automobiles, used for personal pleasure or convenience, can not be claimed; the property must be used for the purpose of producing income.

(b) Depreciation in the value of land, whether improved or unimproved, due to ordinary erosion, exhaustion, or any other cause can not be claimed.

(c) Where, in the course of years, the owner of property has claimed its full cost as depreciation in his income tax returns, no further claim will be allowed.

(d) The value to be cared for by depreciation is the actual amount invested in the property and not the value which may be arbitrarily or otherwise fixed.

(NOTE.—For information relative to deduction for obsolescence see Regulations No. 45.)

92. Am I entitled to deduct under the heading of "Depreciation" shrinkage in the value of work horses and mules purchased and not raised on my farm?

Yes. Purchase of work horses and mules constitute capital outlays, and therefore depreciation sustained may be deducted.

#### DEPLETION.

93. Under what conditions and at what rates may depletion, due to the removal of a natural product from oil or gas wells, mines, quarries, etc., be claimed?

Section 214, paragraph 10, of the revenue act of 1918 states how the amount of depletion allowable as a deduction is to be ascertained, but as so many factors are to be considered in computing depletion, an answer which will be applicable to all cases where depletion occurs can not here be given. Such factors are covered in considerable detail by the Regulations, copies of which may be obtained from the collector of internal revenue for your district, and where these regulations do not afford all the information necessary in your particular case a detailed statement covering all the facts and figures in your case should be forwarded to the collector, with a request for a ruling.

#### GIFTS.

94. How am I to determine to what extent contributions or gifts made to corporations, organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, or to

the special fund for vocational rehabilitation, may be claimed as a deduction?

You should first ascertain what your taxable net income would be were you not entitled to a deduction on account of such contributions or gifts, and then if the aggregate of such contributions or gifts, made during the year to such corporations does not exceed 15 per cent of your taxable net income so computed their aggregate amount may be entered in the space provided therefor under "General deductions" on a personal return form. If such aggregate amount exceeds 15 per cent of your taxable net income so computed, the excess can not be claimed.

For example: Your total taxable net income amounts to \$20,000. During the year you have contributed to the National Red Cross, \$1,000; to the Young Men's Christian Association, \$1,000; toward the construction of a new church, \$1,000; and to the associated charities of your home city, \$500; a total of \$3,500. Fifteen per cent of your total net income amounts to \$3,000; therefor this latter amount may be claimed as a deduction and the balance of your contributions and gifts may not be claimed.

In claiming a deduction on account of such contributions or gifts there should be shown on the return of income (a) the name and address of each organization to which a contribution or gift was made and (b) the date and amount of each such contribution or gift.

Where the contribution or gift was other than money the basis for calculation of its value shall be the fair market value of the property given at the time of contribution or gift.

#### ACCOUNTS KEPT BY USE OF INVENTORIES.

##### 95. What is meant by the "inventory basis" of reporting income?

The inventory basis of keeping accounts requires that a farmer take an inventory at the close of each year, and that his gross income be based upon sales plus the gain or minus the loss during the year as shown in the inventory. A farmer computing his income upon the inventory basis should add to the sales of live stock and other farm products during the year all other income from farming operations and the amount of the inventory at the close of the year, and should deduct therefrom amounts spent in farming operations, including the cost of live stock or produce purchased.

An example of the inventory method of ascertaining the gross income is as follows:

Sales of live stock and products during year.....	\$9, 000
Inventory of live stock and products at close of year.....	4, 000
	<hr/> 13, 000
Inventory of live stock and products at beginning of year.....	\$3, 000
Cost of live stock purchased during year.....	2, 000
	<hr/> 5, 000
Gross income from farming, to be shown on return.....	8, 000

96. If an inventory is used, must the live stock and products entering into the inventory be valued at cost or at market price?

Under the regulations of the Treasury Department inventories may be taken at cost or at market price, whichever is lower.

97. If the inventory method is used, what items should enter into the inventory?

In general, only farm products and live stock, which are the subject of sale, and therefore of income in the ordinary business of the farmer.

98. I keep books of account and use the inventory method as described above. Am I entitled to claim a deduction for loss of live stock included in the inventory, which live stock died during the return year? In other words, is the cost or inventory value of the live stock, which died, a deduction from gross income as a loss?

No. Since the live stock which died was not included in the inventory at the close of the year you received credit for the loss in the reduced inventory at the close of the year, so that if you were to claim a deduction from gross income, as shown on the return, you would be receiving a double deduction in respect of the loss.

99. Am I entitled to deduct under the item "Depreciation" on the return form the decrease in the value of live stock included in the inventory?

No. When the inventory was taken at the close of 1918 the value of the live stock was or should have been decreased to show the depreciation in its value and you, therefore, receive the benefit of the decrease in value in computing gross income. If it were allowed as a deduction on the return it would be a double deduction.

100. Does the internal-revenue bureau require farmers to take inventories and compute net income upon the inventory basis?

No. It is necessary, however, that farmers keep books which shall accurately reflect their gains and profits from their business of farming. If a farmer keeps an accurate record of all receipts from the sales of farm products and of income from every other source and an accurate record of expenses paid or incurred, a return can be made at the close of each taxable year which shall accurately reflect the gains and profits.

#### CREDITS.

101. I understand that a part of the net income is not liable to the normal tax. To what credits am I entitled in arriving at the net income liable to the normal tax?

(a) The amounts received as dividends from a corporation which is taxable within the United States upon its net income.

(b) The amount received as interest upon obligations of the United States which is included in gross income.

(c) The personal exemptions referred to in answers to questions 3, 4, 5, and 6.

## RETURNS OF INFORMATION.

## 102. Are returns of information required of farmers?

Section 256 of the revenue act of 1918 provides in part that all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another individual, corporation, or partnership, of interest, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits \* \* \* of or at the rate of \$1,000 or more in any taxable year \* \* \* shall render a true and accurate return to the commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipients of such payment.

## 103. Upon what forms shall I make returns of information and with whom shall I file such returns?

Returns of information should be filed on Form 1099 (revised) and should be filed with the Commissioner of Internal Revenue on or before March 1 of each year, accompanied by a letter of transmittal, under oath, on Form 1096 (revised).

## 104. I pay an annual rent, exceeding \$1,000, to an agent who refuses to disclose the name of the landlord. May I require the agent to furnish the name and address of his principal in order that I may make a proper return of information?

Yes. When an agent receives, in behalf of his principal, a payment falling within the provisions of law for information at the source, he is required by law to furnish the name and address of the principal upon receipt of a demand therefor from the payer, and in default of a compliance with such a demand the agent becomes liable to a penalty of not more than \$1,000.

## 105. Where a person receives a cash compensation for services rendered, and in addition thereto commissions, living expenses, or other allowances, is the aggregate amount of cash, plus the value to such person of the allowances, to be returned?

Yes. A return is required in each case where the cash compensation, plus the value of the allowances, equals or exceeds \$1,000 for the taxable year.

## PAYMENT, ABATEMENT, AND REFUND OF TAX ASSESSED.

## 106. To whom is an assessment of income tax to be paid?

To the collector of internal revenue with whom your return was filed.

## 107. When does payment of income tax assessed against an individual on a calendar year return become due and payable?

The tax is to be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment is to be paid at the time fixed by law for filing the return, March 15, the second installment is to be paid on the



fifteenth day of June, the third installment on the fifteenth day of September, and the fourth installment on the fifteenth day of December, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted, the time for payment of the first installment is to be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments is not to be postponed unless the commissioner so provides in granting the extension. However, in any case in which the time for the payment of any installment is, at the request of the taxpayer, postponed because of an extension of time for filing the return, there is to be added as part of such installment interest thereon at the rate of  $\frac{1}{2}$  of 1 per cent per month from the time it would have been due had no extension been granted until paid. If any installment is not paid when due the whole amount of the tax unpaid becomes due and payable upon notice and demand by the collector. If any tax is not paid when due the collector will issue a notice and demand therefor, and if at the expiration of 10 days from date of this notice the tax remains unpaid it becomes delinquent. The penalty for such delinquency is 5 per cent of the amount of the unpaid tax and interest at the rate of 1 per cent per month upon such tax from the time the same became due to date of payment.

108. May the income tax due from a taxpayer be paid in a single payment instead of in installments?

Yes. Section 250 of the act provides that the tax may, at the option of the taxpayer, be paid in a single payment, in which case the total amount is to be paid on or before the time fixed by law for filing the return; or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension.

109. What recourse has a taxpayer when he feels that he has been assessed with income tax in excess of his true tax liability?

He may pay the tax under protest and file claim for refund, or he may exercise his right to file with the collector of internal revenue for his district a claim for abatement, executed on Form 47, copies of which may be obtained from the collector. The filing of a bona fide claim prior to the due date of the tax acts as a stay to the collection of the 5 per cent penalty for delinquency in payment, provided, in case of rejection of the claim, the tax due is paid within 10 days from the date of notice of such rejection. However, in case of rejection, interest at the rate of one-half of 1 per cent per month will run from the date the amount was due until the claim is decided.

It should be understood, however, that the filing of a claim for abatement of tax alleged to have been erroneously assessed does not operate as a suspension of the collection of the tax. If the collector feels that the suspension of collection will jeopardize the interests of the Government, he may collect the tax and leave the taxpayer to his remedy by a claim for refund.

110. In 1918 I paid \$50 income tax in excess of my true tax liability for the year 1917. Can this excess payment be applied in payment of a later assessment of tax?

Yes; the excess payment is to be credited against any income, war-profits or excess-profits taxes, or installment thereof, due from the taxpayer at the time of the discovery of the overpayment for the prior year, and any balance of such excess is to be refunded to the taxpayer.

111. Will any information contained in my personal return be disclosed to another?

No. The law specifically provides that any information relative to an individual's income and deductions obtained from his personal return, or otherwise, in connection with the income tax, shall be inviolably confidential, and it is unlawful for any employee of the United States to divulge or make known such information in any manner whatsoever to any person, except the proper officers and employees of the Treasury Department or to the proper officers of a court for use in a trial of any case to which both the United States and the person rendering the return are parties; and any offense against this provision of law will be held to be a misdemeanor and be punishable by a fine not exceeding \$1,000, or imprisonment not exceeding one year, or both, at the discretion of the court, and dismissal from the service of the Government.

112. If my attorney requests a copy of my return or any information relative thereto, will his request be granted?

No; unless the return was rendered by him for and in your behalf, or he submits an authorization, personally signed by you, permitting the copy or information to be given to him.

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